

ASSEMBLY BILL

No. 444

Introduced by Assembly Member Vargas

February 14, 2003

An act to amend Sections 10506.4 and 10507.5 of the Insurance Code, relating to life insurers.

LEGISLATIVE COUNSEL'S DIGEST

AB 444, as introduced, Vargas. Life insurers: guarantees.

Existing law allows a life insurer meeting certain criteria to guarantee, pursuant to an approved policy, contract, or agreement, the value of the assets allocated to a separate account, which as provided under the applicable policy, contract, or agreement is not chargeable with liabilities arising out of any other business the company may conduct, or the investment results thereof, or the income thereon, or the benefits payable pursuant to the approved policy, contract, or agreement, and may transfer to the separate account cash to maintain its reserves for those guarantees, as specified. Existing law allows the commissioner to issue a bulletin setting forth reasonable requirements for insurers issuing policies, contracts, or agreements containing these guarantees.

Existing law allows an insurer to deliver or issue for delivery one or more policies, contracts, or agreements that establish the insurer's obligations under the policies, contracts, or agreements by reference to a portfolio of assets that is not owned by or possessed by the insurer, if certain requirements are met. Existing law requires the commissioner to issue a bulletin setting forth reasonable requirements for insurers that issue these policies, contracts, or agreements.

This bill would allow the commissioner, in addition, to establish administrative procedures, consistent with the requirements of these bulletins, providing for filing the applicable policies, contracts, or agreements with the commissioner for approval prior to issue, and for approval on one or more expedited bases, as specified.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 10506.4 of the Insurance Code is
2 amended to read:

3 10506.4. (a) An admitted life insurer that is financially
4 qualified pursuant to subdivision (b) and complies with the
5 provisions of this section and those of Section 10506 that expressly
6 refer to this section or are not inconsistent with it, may guarantee,
7 pursuant to an approved policy, contract, or agreement, the value
8 of the assets allocated to a separate account, which as provided
9 under the applicable policy, contract, or agreement is not
10 chargeable with liabilities arising out of any other business the
11 company may conduct, or the investment results thereof, or the
12 income thereon, or the benefits payable pursuant to the approved
13 policy, contract, or agreement, and may transfer to the separate
14 account cash to maintain its reserves for those guarantees pursuant
15 to paragraph (2) of subdivision (f) of Section 10506. The general
16 account of the insurer shall be paid reasonable and sufficient
17 compensation not less frequently than quarterly, for risks and other
18 expenses incurred, from any separate account that receives a
19 guarantee authorized by this section.

20 (b) For the purposes of this section “approved policy, contract,
21 or agreement” means a policy, contract, or agreement, the form of
22 which has been approved by the commissioner, for issue or
23 marketing in this state, and which in addition to meeting the
24 requirements of all pertinent provisions of this code, meets the
25 requirements of one of the following paragraphs:

26 (1) A policy, contract, or agreement meets the requirements of
27 this paragraph if it satisfies and is expected to satisfy over the full
28 life of the policy, contract, or agreement all of the following
29 conditions:



1 (A) The weighted asset valuation reserve factor for the assets
2 held in the separate account pursuant to the terms of the policy,
3 contract, or agreement shall not exceed 2 percent.

4 (B) Guarantees of interest that extend beyond 14 months at any
5 time shall be no greater than 3 percent per annum.

6 (C) Any reserves required because the contract value is less
7 than the reserves required for the policy, contract, or agreement
8 shall be maintained in a separate identified segment of the insurer's
9 general account or otherwise segregated within the general
10 account, or be held in a separate account all of the assets of which
11 shall also be chargeable with liabilities arising out of other
12 business of the insurer.

13 (D) In the event the policy, contract, or agreement provides for
14 withdrawals (other than those resulting from an election by a
15 participant under a pension, retirement, retirement medical
16 benefit, or profit-sharing plan) of amounts other than on the
17 conversion date or guarantee effective date, if any, the withdrawals
18 shall be made in either of the following manners:

19 (i) In a lump sum in an amount not to exceed the market value.

20 (ii) In one or more contract value installments the present value
21 of which is equal to or less than the market value of the aggregate
22 withdrawal.

23 (2) A policy, contract, or agreement meets the requirements of
24 this paragraph if it satisfies and is expected to satisfy over the full
25 life of the policy, contract, or agreement all of the following
26 conditions:

27 (A) The weighted asset valuation reserve factor for the assets
28 held in the separate account pursuant to the terms of the policy,
29 contract, or agreement shall not exceed 4 percent.

30 (B) The market value of the assets held in the separate account
31 plus any reserves described in subparagraph (C) shall exceed the
32 current aggregate liabilities determined by discounting the
33 guaranteed benefit liability cash-flows at the rate of 105 percent
34 of the then current yields as quoted on United States Government
35 issued securities having substantially similar maturities by at least
36 the following applicable amount:

37 (i) For assets consisting of debt instruments, an amount equal
38 to the asset valuation reserve "maximum reserve factor,"
39 provided, however, that the factor shall be reduced by 50 percent
40 for the purpose of this calculation if the difference in durations of

1 the assets and liabilities (as confirmed in the actuarial statement
2 referred to in subparagraph (B) of paragraph (1) of subdivision (d))
3 are one year or less.

4 (ii) For assets that are not debt instruments, 20 percent.

5 (C) Any reserves required because the contract value is less
6 than the reserves required for the policy, contract, or agreement
7 shall be maintained in a separate identified segment of the insurer's
8 general account or otherwise segregated within the general
9 account, or be held in a separate account all of the assets of which
10 shall also be chargeable with liabilities arising out of other
11 business of the insurer.

12 (D) In the event the policy, contract, or agreement provides for
13 withdrawals (other than those resulting from an election by a
14 participant under a pension, retirement, retirement medical
15 benefit, or profit-sharing plan) of amounts other than on the
16 conversion date or guarantee effective date, if any, the withdrawals
17 shall be made in either of the following manners:

18 (i) In a lump sum in an amount not to exceed the market value.

19 (ii) In one or more contract value installments the present value
20 of which is equal to or less than the market value of the aggregate
21 withdrawal.

22 (3) A policy, contract, or agreement meets the requirements of
23 this paragraph if it satisfies and is expected to satisfy over the full
24 life of the policy, contract, or agreement all of the following
25 conditions:

26 (A) The guarantees contained in the policy, contract, or
27 agreement applicable to the value of the assets held in the separate
28 account by the insurer shall be based upon a publicly available
29 interest rate series or an index of the aggregate market value of a
30 group of publicly traded financial instruments, the interest rate
31 series or index to be specified in the policy, contract, or agreement.

32 (B) Assets held in the separate account and the accumulations
33 thereon shall be invested in accordance with the requirements of
34 subdivision (a) of Section 10506 applicable to policies, contracts,
35 or agreements governed by this section and shall comply with all
36 of the following:

37 (i) Interest-bearing bonds, notes, or other obligations shall be
38 publicly traded or meet applicable requirements of the United
39 States Securities and Exchange Commission enabling the
40 securities to be publicly traded.

1 (ii) Investments in capital stock shall be traded on an exchange
2 regulated by the United States Securities and Exchange
3 Commission, and investments in any futures contracts with respect
4 thereto shall be traded on an exchange regulated under the
5 Commodities Exchange Act (Title 7, United States Code).

6 (iii) Issuers of interest-bearing obligations held in the separate
7 account must be rated by an independent nationally recognized
8 financial rating agency approved by the commissioner or by the
9 Securities Valuation Office of the National Association of
10 Insurance Commissioners.

11 (iv) With respect to any investments in shares of investment
12 companies registered under the federal Investment Company Act
13 of 1940 (15 U.S.C. Sec. 80a-1 et seq.) the assets of the entity must
14 qualify as investments directly allowed for separate accounts
15 pursuant to the requirements of subdivision (a) of Section 10506
16 applicable to policies, contracts, or agreements governed by this
17 section.

18 (v) The type, quality, industry diversification, prepayment
19 characteristics, expected duration, and other factors pertaining to
20 investments shall be set forth in the approved method of operations
21 which shall contain a demonstration satisfactory to the
22 commissioner that the investments are likely to achieve the
23 performance of the applicable index or interest rate series.

24 (C) The period between the commencement date of the
25 guaranty of the value of the assets held in the separate account and
26 the conversion date, if any, shall not exceed five years.

27 (D) Any reserves required because the contract value is less
28 than the reserves required for the policy, contract, or agreement
29 shall be maintained in a separate identified segment of the insurer's
30 general account or otherwise segregated within the general
31 account, or be held in a separate account all of the assets of which
32 shall also be chargeable with liabilities arising out of other
33 business of the insurer.

34 (E) In the event the policy, contract, or agreement provides for
35 withdrawals (other than those resulting from an election by a
36 participant under a pension, retirement, retirement medical
37 benefit, or profit-sharing plan) of amounts other than on the
38 conversion date or guarantee effective date, if any, the withdrawals
39 shall be made in either of the following manners:

40 (i) In a lump sum in an amount not to exceed the market value.

1 (ii) In one or more contract value installments the present value
2 of which is equal to or less than the market value of the aggregate
3 withdrawal.

4 (4) For the purposes of this section, “conversion date” means
5 the date, if any, specified in the policy, contract, or agreement upon
6 which the assets held pursuant to it shall be converted or applied
7 to the purchase of annuities or returned to the owner of the policy,
8 contract, or agreement, or its designee.

9 (5) For the purposes of this section, the “asset valuation reserve
10 factor” for each asset will be determined by the application of the
11 asset valuation reserve factor, “maximum reserve factor,” as
12 contained in the National Association of Insurance
13 Commissioners (NAIC) Life, Accident and Health Annual
14 Statement Instructions (Instructions) and Valuation of Securities
15 Manual, or if not contained therein, an asset valuation reserve
16 factor of 20 percent shall be assigned. To determine the weighted
17 asset valuation reserve factor, the asset valuation reserve factor
18 shall be applied to the market value of each asset.

19 (6) For the purposes of this section, “market value” means the
20 policy, contract, or agreement’s proportionate share of the actual
21 market value of the separate account at the time of withdrawal or
22 if the determination of market value is by formula, the formula
23 shall be set forth in the policy, contract, or agreement and shall be
24 designed to closely match actual market value.

25 (7) For the purposes of this section, “guarantee effective date”
26 means the date guarantees authorized by this section may result in
27 payments from the general account to the separate account.

28 (c) No admitted life insurer may issue or market in this state,
29 nor may any domestic life insurer issue or market anywhere, a
30 policy, contract, or agreement, or coverage thereunder by
31 certificate or otherwise, which contains the guarantees referred to
32 in subdivision (a) unless both of the following apply:

33 (1) It has received from the commissioner authority to issue
34 policies or contracts providing for the payment of variable benefits
35 pursuant to subdivision (h) of Section 10506.

36 (2) The commissioner has determined after application by the
37 insurer in the form and content as the commissioner may require,
38 review of the insurer’s applicable proposed method of operations
39 relating to policies, contracts, or agreements containing the
40 guarantees authorized by subdivision (a), payment of fees

1 specified in Section 736 and consideration of the matters set forth
2 in subdivision (h) of Section 10506, that the insurer is financially
3 qualified to issue policies, contracts, or agreements that contain the
4 guarantees referred to in subdivision (a) including by meeting or
5 exceeding the financial standards in subdivision (d).

6 (d) (1) No admitted life insurer that has been financially
7 qualified pursuant to subdivision (c) may issue or market or
8 continue to issue or market in this state, nor may any domestic life
9 insurer issue or market anywhere or continue to issue or market
10 anywhere, policies, contracts, or agreements, or coverage
11 thereunder by certificate or otherwise, providing the guarantees
12 referred to in subdivision (a) unless all of the following apply:

13 (A) It has at least one billion dollars (\$1,000,000,000) of
14 admitted assets or at least one hundred million dollars
15 (\$100,000,000) of aggregate capital and surplus.

16 (B) It annually complies with the requirement to furnish an
17 actuarial statement as a part of or in addition to the statement
18 required by Section 10489.15, provided the actuarial statement is
19 in form and substance satisfactory to the commissioner. This
20 actuarial statement shall meet all the following requirements:

21 (i) The statement shall state that, after taking into account risk
22 charges payable from the assets of the separate account with
23 respect to the guarantee, the assets of the separate account, together
24 with any reserves in excess of the account value, make good and
25 sufficient provision for the liabilities of the insurer with respect
26 thereto.

27 (ii) The statement shall provide an opinion of the
28 reasonableness and sufficiency of the pricing of any general
29 account guarantees and any other fees for administration paid to
30 the general account from the separate account.

31 (iii) The statement shall be supported by a memorandum by a
32 qualified actuary, also in form and substance satisfactory to the
33 commissioner, that describes the calculations made in support of
34 the actuarial statement and includes the assumptions used in the
35 calculations.

36 (C) Its ratio of aggregate capital and surplus to its aggregate
37 liabilities is not lower than 75 percent of such ratio as of the
38 December 31 prior to its receiving financial qualification from the
39 commissioner except as allowed under paragraph (4) of
40 subdivision (d).

1 For the purposes of this section, “capital and surplus” includes
2 capital and surplus plus the asset valuation reserve and one-half of
3 the liability for dividends, all as reflected on the most recent
4 financial statement on file with the commissioner. “Liabilities”
5 means the total liabilities as reflected on the financial statement
6 excluding therefrom liabilities for policies, contracts, and
7 agreements issued in connection with separate accounts, liabilities
8 in connection with contracts issued pursuant to this section and
9 excluding both of the following:

10 (i) The liability for any asset valuation reserve.

11 (ii) One-half the liability for dividends.

12 (2) If the commissioner, following notice to the insurer and a
13 hearing, determines that an insurer that has received financial
14 qualification pursuant to subdivision (c) no longer maintains the
15 financial strength needed to initially receive the qualification, the
16 commissioner may issue an order requiring the insurer to cease
17 issuing new policies, contracts, or agreements providing for
18 guarantees contemplated by subdivision (a).

19 (3) In the event an insurer that has received financial
20 qualification pursuant to subdivision (c) determines that it does not
21 meet the requirements of subdivision (d), it shall promptly comply
22 with paragraph (2) as if an order had been issued by the
23 commissioner after notice and hearing, and within 45 days, notify
24 the commissioner in writing at the place designated by the
25 commissioner that it has ceased to meet the requirements specified
26 in the written notice.

27 (4) In the event the insurer thereafter meets or exceeds all of the
28 requirements of subdivision (d), it may notify the commissioner
29 at the place designated by the commissioner, in writing, and upon
30 the passage of 45 days following receipt by the commissioner of
31 the notice, may resume issuing policies, contracts, or agreements
32 that provide for guarantees contemplated by subdivision (a) as
33 long as it meets the requirements of subdivision (d). However, if
34 the insurer believes that the resumption of the issuance of the
35 policies, contracts, or agreements that provide for the guarantees
36 contemplated by subdivision (a) would not be hazardous to its
37 policyholders or the citizens of California, even though it does not
38 meet the requirements specified in subparagraph (C) of paragraph
39 (1), the insurer shall include in the notice a demonstration that the
40 issuance of policies, contracts, or agreements containing the



1 guarantees referred to in subdivision (a) is not hazardous to its
2 policyholders or the citizens of California. Within the 45-day
3 period, the commissioner may issue an order containing the
4 requirements of paragraph (2) if, in the commissioner's opinion,
5 any of the requirements of subdivision (d) are not met, or
6 resumption would violate any provision of this code or,
7 resumption may be hazardous to the insurer, policyholders,
8 creditors, or the public. The failure to issue an order within 45 days
9 shall not be deemed an approval of the activities. The order shall
10 specify the grounds upon which the commissioner is basing the
11 order. The insurer may, within 10 days of the order, request a
12 hearing. The hearing shall be a private hearing and shall
13 commence not less than 10 days, nor more than 20 days, after the
14 request for hearing is served on the commissioner.

15 (e) Policies, contracts, and agreements containing guarantees
16 referred to in subdivision (a), that are not otherwise subject to
17 filing under applicable law and regulation, shall be filed, before
18 being marketed or issued in this state, by the insurer with the
19 commissioner. If the commissioner finds that the policies,
20 contracts, or agreements submitted pursuant to subdivision (a)
21 contemplate practices that are unfair or unreasonable or otherwise
22 inconsistent with the provisions of this code, he or she may
23 disapprove of the forms of policies, contracts, or agreements
24 specifying in what regard the policies, contracts, or agreements are
25 unfair or unreasonable or otherwise inconsistent with the
26 provisions of this code.

27 (f) The commissioner may issue a bulletin setting forth
28 reasonable requirements for insurers issuing policies, contracts, or
29 agreements containing guarantees referred to in subdivision (a)
30 relating to all of the following:

31 (1) The reserves to be maintained by insurers for those policies,
32 contracts, or agreements.

33 (2) The accounting and reporting of funds credited under those
34 policies, contracts, or agreements.

35 (3) The disclosure of information to be given to holders and
36 prospective holders of those policies, contracts, or agreements.

37 (4) The qualification of persons selling those policies,
38 contracts, or agreements on behalf of the insurers.

39 (5) The filing of those policies, contracts, or agreements with
40 the commissioner.

(6) Other matters relating to those policies, contracts, and agreements as the commissioner considers necessary, proper, and advisable that are not inconsistent with this section.

The bulletin authorized by this subdivision shall have the same force and effect, and may be enforced by the commissioner to the same extent and degree, as regulations issued by the commissioner until the time that the commissioner issues additional or amended regulations. *The commissioner may establish administrative procedures consistent with the requirements of the bulletin authorized by this subdivision, which shall provide for filing those policies, contracts, or agreements with the commissioner for approval prior to issue, and for approval on one or more expedited bases. An expedited approval procedure may allow for approval based upon certifications by the insurer that the filing complies with the bulletin and the applicable provisions of this code.*

(g) The authority granted in this section is in addition to the authority granted to life insurers by other provisions of this code and the requirements of this section shall not contravene that authority. No policy, contract, or agreement that constitutes investment return assurance pursuant to Section 10203.10 or Section 10507 may be issued pursuant to this section.

(h) Guarantees authorized by this section may only be made in connection with policies, contracts, or agreements issued to an owner that is not a natural person, and is an “accredited investor” as defined in Regulation D-Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, 17 Code of Federal Regulations Section 230.501 et seq., as promulgated by the United States Securities and Exchange Commission, in transactions where the aggregate single premium or deposit for all policies, contracts, or agreements (excluding certificates issued under a group or master policy) issued to the owner containing guarantees authorized by this section is at least one million dollars (\$1,000,000). Notwithstanding the foregoing, an insurer may issue policies, contracts, or agreements qualifying under paragraph (1) of subdivision (b) above, to a pension, retirement, or retirement medical benefit or profit-sharing plan reasonably expected to receive contributions in excess of two hundred fifty thousand dollars (\$250,000) within the first 12 months following issuance of the policy, contract, or agreement and that has more than 10 participants. Policies, contracts, or

1 agreements providing coverage in this state, by certificate or
2 otherwise, that contain guarantees authorized by this section
3 issued on a group basis shall be issued only to groups referred to
4 in Chapter 2 (commencing with Section 10200) of Part 2 of
5 Division 2.

6 SEC. 2. Section 10507.5 of the Insurance Code is amended to
7 read:

8 10507.5. (a) An insurer may deliver or issue for delivery one
9 or more policies, contracts, or agreements that establish the
10 insurer's obligations under the policies, contracts, or agreements
11 by reference to a portfolio of assets that is not owned by or
12 possessed by the insurer, if the following requirements are met:

13 (1) The insurer is authorized to deliver, or issue for delivery,
14 life insurance policies in this state.

15 (2) The insurer has at least one billion dollars (\$1,000,000,000)
16 in admitted assets or one hundred million dollars (\$100,000,000)
17 in capital and surplus, as reflected by the most recent financial
18 statements on file with the commissioner. For the purposes of this
19 section, "capital and surplus" includes capital and surplus plus the
20 asset valuation reserve and one-half of the liability for dividends,
21 all as reflected on the most recent financial statement on file with
22 the commissioner.

23 (b) The commissioner shall issue a bulletin setting forth
24 reasonable requirements for insurers that issue policies, contracts,
25 or agreements described in subdivision (a). The bulletin shall have
26 the same force and effect, and may be enforced by the
27 commissioner to the same extent and degree, as regulations issued
28 by the commissioner until the time that the commissioner issues
29 additional or amended regulations. *The commissioner may*
30 *establish administrative procedures consistent with the*
31 *requirements of the bulletin authorized by this subdivision, which*
32 *shall provide for filing those policies, contracts, or agreements*
33 *with the commissioner for approval prior to issue, and for*
34 *approval on one or more expedited bases. An expedited approval*
35 *procedure may allow for approval based upon certifications by the*
36 *insurer that the filing complies with the bulletin and the applicable*
37 *provisions of this code.*